Reality of social investing

THROUGHOUT the nation, activists understandably troubled by the ongoing tragedy in Darfur have pressed public pension plans to divest the stock of corporations with varying connections to Sudan. The impulse animating these divestment policies is commendable. After the Holocaust consumed European Jewry, the international community formally declared that no government would ever again be allowed to exterminate a people. Alas, even before Darfur, such anti-genocide avowals rang hollow.

In a similar vein, other equally sincere activists press public pension plans to jettison the stocks of corporations with ties to Iran. These activists often characterize their objective as "terror-free" pension portfolios.

These divestment proposals are the most recent manifestations of the program typically denoted as "social investing," the use of pension resources to accomplish political and ethical objectives. While the motivations of those seeking Darfur and Iranian divestment are beyond reproach, the tactic they pursue is not. Three inconvenient truths indicate that, however well-intended, social investing of governmental pension assets is at best ineffective and at worst costly to retirees and taxpayers.

■ Inconvenient truth No. 1: Whatever its symbolic value, divestment is not economically effective but, rather, constitutes a game of musical chairs. Divestment merely transfers ownership of certain stocks from those with moral qualms to those without. When a public pension plan sells the stock of a corporation doing business in Sudan, someone else buys that stock. The resulting shift does not change the underlying economics of doing business in Sudan, but merely reshuffles equity ownership—at best, a symbolic statement.

Various socially sensitive investment funds claim that they obtain for their investors risk-adjusted market rates of returns. If so, these funds, however well-intentioned, accomplish nothing of economic consequence. Rather, they merely confine their portfolios to certain types of market- rate investments while ceding the remaining universe of such investments to others. This reshuffling does not affect the market-driven allocation of resources.

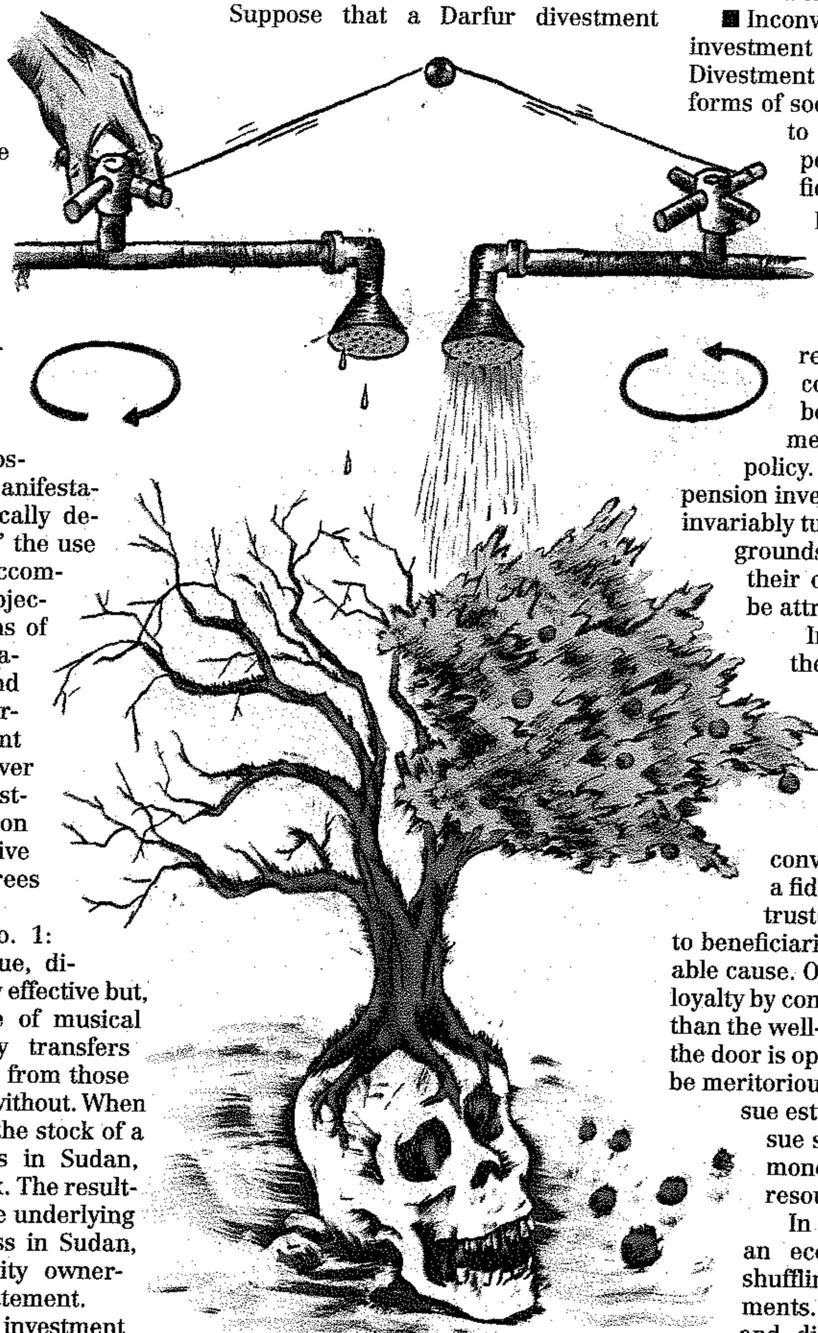
■ Inconvenient truth No. 2: Below-market-rate social investments have real, but hidden, costs. When divestment causes public pension plans to hold suboptimal investment portfolios, there are hidden costs for taxpayers and retirees in the form of reduced retirement resources.

Suppose that a Darfur divestment program leads a public pension to accept below-market returns. In the context of public defined-benefit plans, the failure to earn market-rate returns ultimately requires taxpayers to contribute more to public pension funds to finance the benefits promised to state and local employees. In the case of defined contribution plans, such a failure leaves governmental retirees with smaller account balances at retirement. Either way, divestment imposes real, albeit delayed, costs. Concern about below-market-rate investments is particularly compelling in light of the widespread underfunding of state and local pension plans. Taxpayers and retirees legitimately expect public pension assets to be invested prudently and productively. Suboptimal returns leave them with the short end of the proverbial pension stick.

■ Inconvenient truth No. 3: Social investment dilutes fiduciary standards. Divestment for worthy causes, like other forms of social investing, opens the door to less noble uses of public pension funds by diluting the fiduciary standards governing pension trustees' investment decisions. Suppose that a group seeks to use public retirement assets to support the Hamas-dominated regime in Gaza. There are, of course, persuasive distinctions between an anti-Sudan investment policy and a pro-Hamas policy. However, politicizing public pension investments for good causes will invariably turn such pensions into battlegrounds as others seek support for their causes, not all of which will be attractive.

Instructive in this context are the traditional standards of fiduciary conduct including, in Benjamin N. Cardozo's famous formulation, "the duty of undivided loyalty." The insight animating this formulation is convincing: It does not matter if a fiduciary (like a public pension trustee) dilutes his or her loyalty to beneficiaries' welfare for a commendable cause. Once fiduciaries weaken that loyalty by considering any objective other than the well-being of their beneficiaries, the door is opened to causes that may not be meritorious. Even if trustees only pursue estimable objectives, they pursue such objectives with others' money, i.e., retirees' retirement resources.

In sum, divestment is, at best, an economically ineffective reshuffling of market-rate investments. It imposes hidden costs and dilutes fiduciary standards. The advocates of Darfur and Iranian divestment programs are well-meaning proponents of morally persuasive causes. They can (and should) pursue approaches with transparent costs and compelling benefits, e.g., higher gas taxes to reduce our dependence on foreign oil or direct appropriations to groups doing humanitarian work in Darfur. Divestment, however, is not such an approach. In the final analysis, good intentions are not enough. NLJ



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